

# FISCAL NOTE

**Bill #:** HB763      **Title:** Temp. increase cigarette tax; transfer funds from coal trust fund and repayment

**Primary Sponsor:** Kim Gillan      **Status:** Introduced

|                   |      |                                 |      |
|-------------------|------|---------------------------------|------|
| Sponsor signature | Date | Chuck Swysgood, Budget Director | Date |
|-------------------|------|---------------------------------|------|

## Fiscal Summary

|  | <b><u>FY 2004<br/>Difference</u></b> | <b><u>FY 2005<br/>Difference</u></b> |
|--|--------------------------------------|--------------------------------------|
| <b>Expenditures:</b>                           |                                      |                                      |
| General Fund                                   | (\$28,500,000)                       | \$500,000                            |
| State Special – Guarantee Account              | \$29,000,000                         |                                      |
| Trust Fund – Coal Severance Tax Permanent Fund | \$29,000,000                         |                                      |
| <b>Revenue:</b>                                |                                      |                                      |
| General Fund                                   | \$22,056,466                         | \$19,455,430                         |
| State Special Revenue                          |                                      |                                      |
| Guarantee Account                              | \$29,000,000                         |                                      |
| Long Range Building Prog                       | (\$109,077)                          | (\$133,789)                          |
| DPHHS - Veterans Home                          | (\$78,671)                           | (\$95,928)                           |
| Trust Fund - Coal Severance Tax Permanent Fund | \$3,758,738                          | \$3,649,507                          |
| <b>Net Impact on General Fund Balance:</b>     | <b>\$50,556,466</b>                  | <b>\$18,955,430</b>                  |

- |   |   |
|---|---|
| <input type="checkbox"/> Significant Local Gov. Impact<br><input type="checkbox"/> Included in the Executive Budget<br><input type="checkbox"/> Dedicated Revenue Form Attached | <input checked="" type="checkbox"/> Technical Concerns<br><input checked="" type="checkbox"/> Significant Long-Term Impacts<br><input checked="" type="checkbox"/> Needs to be included in HB 2 |
|---|---|

## Fiscal Analysis

### ASSUMPTIONS:

#### **Cigarette Tax Revenue Impacts**

1. The current law cigarette tax rate is \$0.18 per pack; under this proposal, the cigarette tax rate is increased by \$0.47 to \$0.65 per pack. This tax increase would be in effect for the period July 1, 2003 through at least June 30, 2013. (The increase could be in effect longer if it takes a longer time to repay the \$29 million transfer from the coal tax trust to the guarantee account provided for in 20-9-622 under the conditions of the bill.)
2. Under current law, cigarette tax revenues, after tribal revenue sharing payments, are distributed 73.04% to the state general fund; 15.85% to the Long-Range Building Program Account; and 11.11% to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes.

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3. Under this proposal, cigarette tax revenues, after tribal revenue sharing payments, are distributed 82.19% to the state general fund; 4.36% to the Long-Range Building Program Account; and 3.05% to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes, during the period July 1, 2003 through at least June 30, 2013.
4. Increasing the cigarette tax rate from \$0.18 to \$0.65 per pack will generate new net revenue of \$25,511,708 in fiscal 2004 and \$24,594,418 in fiscal 2005.
5. Revenue to the state general fund will *increase* by \$21,940,869 in FY04 and \$21,174,636 in FY05.
6. Revenue to the long-range building program account will *decrease* by (\$109,077) in FY04 and (\$133,789) in FY05.
7. Revenue to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes will *decrease* by \$(78,671) in fiscal 2004 and \$(95,928) in fiscal 2005.
8. Transfers of cigarette tax to the coal severance tax trust fund will total \$3,758,738 in FY04 and \$3,649,507 in FY05.
9. Discount rates that wholesalers receive are reduced from 6%, 4%, and 3% (based on volume) to 1.77%, 1.19%, and 0.89%, respectively. At these rates the total amount of discounts to wholesalers will be approximately equal to current law amounts.
10. The impacts in assumption five are calculated using a model developed by the Department of Revenue (DOR). The Revenue and Transportation Committee (RTC) cigarette tax revenue estimate under current law for fiscal years 2004 and 2005 is used as the base. In addition to RTC's base estimate, a price elasticity of demand for cigarettes of 0.44 is used in this model. The model assumes the price of a pack of cigarettes will increase by the same amount (in dollars) of a tax increase. Given a base cost of \$3.21 per pack, which is used in this model, and an elasticity of 0.44, each penny increase in the price of a pack of cigarettes results in a decrease in demand of 0.14%.
11. The cigarette tax impacts provided for in this fiscal note include impacts associated with the price elasticity of demand for cigarettes, but do not include forecasts of declines in consumption of taxable cigarettes due to Internet sales of cigarettes, the impacts of current and future local government resolutions providing for non-smoking ordinances, or the effects of future increased tobacco prevention programs. These issues are being explored by the Department and will be incorporated in cigarette tax change impact analyses as data and forecast methodologies are further developed and refined.
12. The following table shows the summary of the impacts from the cigarette tax increase under the assumption that there will not be significant stockpiling of cigarettes taxed at \$0.18 per pack and there will not be significant amounts of illegal sales of cigarettes.

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**Table 1**  
**HB763 (2003 Session) As Introduced**  
**Cigarette Tax Rate Increase Impacts<sup>1</sup>**

|   | <b>FY2004</b>        | <b>FY2005</b>        |
|---|----------------------|----------------------|
| <b>Tax Rate</b>                               |                      |                      |
| Tax Rate - Current Law                        | \$0.18               | \$0.18               |
| <b>Tax Rate - Proposal</b>                    | <b>\$0.65</b>        | <b>\$0.65</b>        |
| <b>Tax Increase of:</b>                       | <b>\$0.47</b>        | <b>\$0.47</b>        |
| <b>Price</b>                                  |                      |                      |
| Price - Current Law                           | \$3.21               | \$3.21               |
| Price - Proposed Law                          | \$3.68               | \$3.68               |
| <b>% Change In Price</b>                      | <b>14.64%</b>        | <b>14.64%</b>        |
| <b>Consumption -Pack of Cigs.<sup>2</sup></b> |                      |                      |
| Consumption - Current Law                     | 60,444,444           | 59,688,889           |
| Consumption - Proposed Law                    | 56,550,391           | 55,843,511           |
| <b>Change In Consumption</b>                  | <b>(3,894,053)</b>   | <b>(3,845,378)</b>   |
| <b>% Change In Consumption</b>                | <b>-6.4%</b>         | <b>-6.4%</b>         |
| <b>Net Revenue<sup>3</sup></b>                |                      |                      |
| Revenue - Current Law                         | \$ 10,630,000        | \$ 10,497,000        |
| Revenue - Proposed Law                        | \$ 36,141,708        | \$ 35,091,418        |
| <b>Change In Revenue</b>                      | <b>\$ 25,511,708</b> | <b>\$ 24,594,418</b> |
| <b>% Change In Revenue</b>                    | <b>240.0%</b>        | <b>234.3%</b>        |
| <b>Current Law Distribution</b>               |                      |                      |
| General Fund (73.04%)                         | \$ 7,764,000         | \$ 7,667,000         |
| LRBP (15.85%)                                 | \$ 1,684,855         | \$ 1,663,775         |
| DPHHS (Vet. Nursing Homes) (11.11%)           | \$ 1,180,993         | \$ 1,166,217         |
| <b>Proposed Law Distribution</b>              |                      |                      |
| General Fund (82.19%)                         | \$ 29,704,869        | \$ 28,841,636        |
| LRBP (4.36%)                                  | \$ 1,575,778         | \$ 1,529,986         |
| DPHHS (Vet. Nursing Homes) (3.05%)            | \$ 1,102,322         | \$ 1,070,288         |
| Coal Severance Tax Trust Fund (10.4%)         | \$ 3,758,738         | \$ 3,649,507         |
| <b>Change in Revenue</b>                      |                      |                      |
| <b>General Fund</b>                           | <b>\$ 21,940,869</b> | <b>\$ 21,174,636</b> |
| <b>LRBP</b>                                   | <b>\$ (109,077)</b>  | <b>\$ (133,789)</b>  |
| <b>DPHHS (Vet. Nursing Homes)</b>             | <b>\$ (78,671)</b>   | <b>\$ (95,928)</b>   |
| <b>Coal Severance Tax Trust Fund</b>          | <b>\$ 3,758,738</b>  | <b>\$ 3,649,507</b>  |

<sup>1</sup>The impacts are calculated on the basis that there will not be significant stockpiling by wholesalers and retailers, and there will not be significant amount of illegal sales of cigarettes.

<sup>2</sup>Consumption (packs) is estimated using gross collections as the base.

<sup>3</sup>Net revenue is gross revenue minus tribal payments and discounts.

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### Coal Tax Trust Impacts

13. In fiscal 2004, \$3,758,738 in cigarette tax would be deposited in the coal severance tax permanent fund (see technical note 2). Deposits would be made in approximately even monthly amounts. The average balance for the year would be increased by the average monthly deposit multiplied by the average fraction of a year remaining when each deposit is made. This is 11/24 of total deposits for the year. The interest rate earned on the trust fund is projected to be 6.71% in fiscal 2004. Interest earnings deposited in the general fund would be increased by \$115,597 ( $6.71\% \times (11/24) \times \$3,758,738$ ).
14. In fiscal 2005, \$3,649,507 in cigarette tax would be deposited in the coal severance tax permanent fund. This would increase the average balance by \$5,431,429 ( $\$3,758,738 + (11/24) \times \$3,649,507$ ). The interest rate earned on the trust fund is projected to be 6.79%. Interest earnings on these additional balances would be \$368,794 ( $6.79\% \times \$5,431,429$ ).
15. This bill would authorize a transfer of up to \$29 million from the coal severance tax trust fund to the guarantee account before the end of fiscal 2004. The Office of Budget and Program Planning would determine the amount and timing of any transfers. This fiscal note assumes that \$29 million would be transferred at the end of fiscal 2004.
16. To obtain funds for the transfer, the Board of Investments would sell \$29 million in bonds that it holds in the Trust Fund Bond Pool and reduce the coal severance tax permanent fund's holdings of Trust Fund Bond Pool shares by \$29 million. The projected interest rate on the Trust Fund Bond Pool for FY05 is 7.2%. This is higher than the interest rate for the coal severance tax trust fund because part of the trust fund portfolio consists of below-market-rate loans to Montana businesses. This transfer would reduce interest earnings paid to the general fund by \$2.088 million in fiscal 2005 ( $7.2\% \times \$29$  million). The net effect on interest earnings to the general fund would be a reduction of \$1,719,206 ( $\$2,088,000 - \$368,794$ ).
17. Interest rates are projected to increase between now and the end of FY04. For every 1 percentage point increase in interest rates, the market price of bonds in the Trust Fund Bond Pool portfolio is projected to decrease by 7%. The yield on new 30-year Treasury bonds was 4.779% on December 31, 2002 and is projected to increase to 6.3939% on June 29, 2004. If this occurs, the Trust Fund Bond Pool would incur losses of approximately \$1.56 million on the sale of assets with a market value of \$29 million.
18. Realized capital gains or losses of the Trust Fund Bond Pool are distributed as part of the earnings of the trust funds that own shares of the pool in proportion to their holdings. The coal severance tax permanent trust and the school trust own about two-thirds of the shares. About two-thirds of any loss would show up as lower trust fund earnings going to the general fund and the guarantee account. About one-third would show up as lower earnings on other state trust funds.

### Administrative Impacts and Appropriations

19. This bill appropriates \$500,000 from the general fund to the Board of Regents to fund community colleges in each year of the biennium.
20. The \$29 million deposited in the Guarantee Fund in FY2004 is statutorily appropriated and will reduce general fund expenditures for school equalization by an equivalent amount in FY2004.
21. The Department of Revenue would incur costs relating to the change in cigarette tax rate, but they would not be significant.

### FISCAL IMPACT:

|                                | <u>FY 2004</u><br><u>Difference</u> | <u>FY 2005</u><br><u>Difference</u> |
|--------------------------------|-------------------------------------|-------------------------------------|
| <u>Expenditures:</u>           |                                     |                                     |
| Transfers – Community Colleges | \$500,000                           | \$500,000                           |
| Transfers – Permanent Trust    | \$29,000,000                        |                                     |

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Funding of Expenditures:

|                                |                |           |
|--------------------------------|----------------|-----------|
| General Fund (01)              | (\$28,500,000) | \$500,000 |
| State Special – Guarantee Fund | \$29,000,000   |           |
| Trust Fund (09)                | \$29,000,000   |           |

Revenues:

|                                   |              |              |
|-----------------------------------|--------------|--------------|
| General Fund (01)                 | \$22,056,466 | \$19,455,430 |
| State Special Revenue (02)        |              |              |
| Guarantee Account                 | \$29,000,000 |              |
| Long Range building Program       | (\$109,077)  | (\$133,789)  |
| DPHHS - Veterans Nursing Home     | (\$78,671)   | (\$95,928)   |
| Trust Funds (09)                  |              |              |
| Coal Severance Tax Permanent Fund | \$3,758,738  | \$3,649,507  |

Net Impact to Fund Balance (Revenue minus Funding of Expenditures):

|                                   |                |              |
|-----------------------------------|----------------|--------------|
| General Fund (01)                 | \$50,556,466   | \$18,955,430 |
| State Special Revenue (02)        |                |              |
| Guarantee Account                 | \$0            |              |
| Long Range building Program       | (\$109,077)    | (\$133,789)  |
| DPHHS - Veterans Nursing Home     | (\$78,671)     | (\$95,928)   |
| Trust Funds (09)                  |                |              |
| Coal Severance Tax Permanent Fund | (\$25,241,262) | \$3,649,507  |

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

None.

LONG-RANGE IMPACTS:

The cigarette tax increase in this bill and the changes in cigarette tax revenue allocation would be in effect through fiscal 2013 or until deposits of cigarette tax revenue into the coal severance tax trust fund equal \$29 million plus interest at 6.75%. Interest earnings to the general fund would be reduced until cigarette tax deposits to the coal severance tax trust fund equal \$29 million and would be increased after \$29 million had been deposited.

TECHNICAL NOTES:

1. The coal severance tax trust fund consists of several subfunds. This bill does not specify which subfund or subfunds the transfer is to be made from. It also does not specify who is to make that decision. This fiscal note assumes that the transfer would be made from the permanent fund. If part of the transfer were from the Treasure State Endowment Fund or the Treasure State Endowment Regional Water System Fund, the reduction in interest earnings would be divided between the general fund, the treasure state endowment program, and the regional water system program in the proportion that funds were transferred from each subfund.
2. This bill does not specify which subfund or subfunds of the coal severance tax trust fund are to receive deposits of cigarette tax revenue. This fiscal note assumes that deposits would be made to the permanent fund. However, in the absence of legislative direction, it could be argued that this decision is being left to the discretion of the Budget Director and the Director of the Department of Revenue.

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3. This bill does not have any provisions relating to the transition between cigarette tax rates. Without such transition language, wholesalers will be able to charge their customers the new tax rate on tax stamps they bought from the Department of Revenue under the old rate.
4. The bill may be perceived as a “loan” from the Trust, rather than a transfer. If it is a loan, rather than a transfer and a payable for the loan amount is booked in the state special revenue fund the transaction may not increase the special revenue fund ending balance.